# Section 588FA claims – location, location, location

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## Summary

A cause of action based on section 588FA does not necessarily arise in the jurisdiction where it becomes complete. Rather, the Court will look at the series of relevant events to determine where, in substance, the cause of action arose.

That which is attacked under section 588FA is the disposition of property (eg a payment) in respect of an unsecured debt or claim. A debt may be secured by a number of means. These include the equitable lien available to a purchaser who has made payment but has not received title to the subject property.

## Legislation

The elements of a liquidator's preference claim are set out in section 588FA of the *Corporations Act 2001* (Cth) ('the Act'). In short, a liquidator may recover payments (for example) made by an insolvent company to a creditor in the six months leading up to that company's liquidation if those payments gave the creditor a priority of advantage over other creditors - that is, more than the creditor would have received if the creditor had not been paid but had instead proven in the liquidation.

The same section however makes clear that secured creditors are exempt – that is, creditors holding a debt or claim the subject of a security interest (section 51E).

## Background

*Hunter Valley Foods* concerned an unfair preference claim made by the liquidators of Hunter Valley Australia Foods Pty Limited (HVA) against one of HVA's creditors, a Singaporean company, Austri-Asia Foods Pty Ltd (Austri).

18 months prior to the liquidation, Austri agreed to buy HVA's assets and business for $4 million. As part of the agreement Austri paid a deposit of $1m, which was to be refunded if the agreement were to be terminated (regardless of which party was at fault).

Soon thereafter Austri (validly) terminated the agreement. The parties entered a deed of 'release' (the Deed) in relation to the refund of the deposit, whereby it was agreed that $975,000 of the deposit would be returned.

Some eight months later, the $975,000 having not yet been returned, HVA agreed to sell its business and assets to a Victorian company, 100% Bottling Company Pty Ltd (Bottling). As part of this agreement HVA was to give Bottling notice of the amount to be paid to Austri.

When it came time to complete the sale to Bottling, HVA's lawyers authorised and directed Bottling's lawyers as to payment of the balance of the purchase moneys (nearly $7.4m). There were six different amounts, one of which was $975,000 paid to Austri's lawyers. A single cheque for the $7.4m was drawn on a Victorian bank account and settlement successfully took place in NSW (where the lawyers for HVA and for Bottling were based). From this amount Austri received its $975,000. There was no evidence as to the sequence of events giving rise to the means by which the six payments were distributed.

Five months after completion, HVA went into liquidation.

The Court was asked to determine two things:

1. Was the cause of action one which arose in Victoria or NSW; and
2. Was the $975k deposit a secured debt (thus making Austri a secured creditor)?

## The first question – where the cause of action arose

Austri argued that the cause of action arose where the payment was made and that this was in Victoria, as the funds came from a Victorian company – Bottling – and the money was originally drawn from a Victorian bank account. (In so arguing, Austri was attempting to show that the Supreme Court of NSW had no jurisdiction, doubtless with a view to having the proceedings disposed of summarily in its favour.)

The Court rejected this reasoning. It ruled that a cause of action arises under section 588FA wherever the "relevant act" was made by the payer (HVA), not necessarily where the funds came from. The correct approach is to therefore look back over the series of events and ask where "in substance" the cause of action arose.

For the Court, the removal of funds from the Victorian bank account was not the relevant act. That act was effected by HVA's lawyers, acting on behalf of HVA. The relevant act was the giving by HVA's lawyers of the direction to Bottling's lawyers that Austri be paid the $975,000. HVA's lawyers were located in NSW, as were Bottling's lawyers. It was this direction that in substance caused the depletion of HVA's assets, and it was given and received in NSW (where settlement also took place). The cause of action thus arose in NSW.

## The second question – was Austri a secured creditor?

The next issue concerned the nature of Austri's relationship with HVA - was Austri a secured or unsecured creditor at the time of payment?

To answer this question, the Court first noted that it is well-established that payments made towards a purchase price (such as a deposit) give rise to an 'equitable lien'. In its explanation the Court quoted from the High Court's judgment in *Hewett v Court (1983)* 149 CLR 639 at 664 as follows:

> "If the property has not passed to the purchaser and the purchaser has paid the whole or part of the purchase price, the purchaser will, in the absence of express or implied agreement to the contrary, enjoy the benefit and equitable lien over the subject land to secure the repayment to him of any part of the purchase price which may become repayable to him upon default by the vendor in the performance of the contract."

As was also noted by the Court this principle applies to personal property as well as to real property. It is also clear that the right to the lien does not depend on who was responsible for the contract going off, except that it does not apply to the extent that under the contract a deposit is forfeited.

The existence of the right to the equitable lien was critical to the outcome of the case. By reason of sections 51A and 51E of the Act, a holder of an equitable lien is considered a "secured creditor". Being so characterised gives the creditor automatic protection (to the extent of the value of its security) from a claim under section 588FA.

In an attempt therefore to dispute Austri's secured creditor status, the liquidators argued that the equitable lien obtained by Austri following payment of the $1m deposit was extinguished by the Deed (signed 12 months before liquidation), both on the Deed's terms and because the Deed negated the unconscionability Austri would have suffered in 'losing' its lien in the HVA sale to Bottling.

The Court rejected this argument. For one, the Deed's release clause was expressly "subject to payment of the [deposit]" and therefore no extinguishment of the lien could occur without payment. Meanwhile the fact that the sale agreement to Bottling provided for payment to Austri from the sale proceeds favoured rather than negated the proposition that Bottling and HVA both still considered the lien in existence up until the HVA sale. Austri was therefore a secured creditor (for the full $975,000) at the time of the impugned payment and thus the payment could not be caught by section 588FA.

The Court therefore dismissed the liquidators' claim.

## Implications

*Hunter Valley Foods* is a timely reminder for liquidators and creditors to consider the series of events (not just the last step) in the transaction giving rise to the alleged unfair preference.

Further, while the introduction of the *Personal Property Securities Act 2009* (Cwth) has added a new level of complication to the concept of secured creditor (see for example *Hussain v CSR Building Products, in the matter of FPJ Group Pty Ltd (in Liq)* [2016] FCA 392), long standing equitable principles may also come to the aid of creditors in asserting the existence of a security interest.

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